In the Supreme Court of the United States

October Term, 1976

No. 76-798

A. H. Robins Company, Inc.,

Petitioner,

vs.

Department of Health of the State of California (formerly Department of Health Care Services of the Human Relations Agency, State of California, et al.,

Respondents.

Petition for Writ of Certiorari To the Court of Appeal For the State of California Third Appellate District

Edgar B. Washburn
Landels, Ripley & Diamond
450 Pacific Avenue
San Francisco, California 94133
Telephone: (415) 788-5000
Attorney for Petitioner,
A. H. Robins Company, Inc.

SORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

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Petitioner, A. H. Robins Company, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Court of Appeal for the State of California, Third Appellate District, entered in these proceedings on July 1, 1976.

OPINION BELOW

The opinion of the Court of Appeal of the State of California, Third Appellate District, reported in 59 Cal.App. 3d 903 (1976) is attached hereto as Appendix I and incorporated herein by reference.

JURISDICTION

The opinion of the Court of Appeal, Third Appellate District, was filed on July 1, 1976. A timely Petition for Hearing before the Supreme Court of the State of California was denied on September 15, 1976, and this Petition for Certiorari is filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Is a California statute which requires a drug manufacturer to make available to all Medi-Cal prescription drug providers the same drugs at the same price in order to be eligible for the State of California's approved Medi-Cal drug formulary list unconstitutional in that it is preempted by and in irreconcilable conflict with the federal anti-trust laws and the Federal Social Security Act?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Cal. Welf. & Inst. Code § 14053.5.
2. Robinson-Patman Act, 15 U.S.C. § 13(a)-(f).
3. Title XIX, Social Security Act, 42 U.S.C. § 1396a.
4. United States Constitution, Article VI.

The applicable statutory and constitutional provisions are attached hereto as Appendix II and incorporated herein by reference.

STATEMENT OF THE CASE

The A. H. Robins Company [hereinafter "Robins"] petitioner herein, is a Virginia corporation which manufactures and sells pharmaceutical products throughout the United States. [S.R. 28.][1] Among the products which Robins distributes are ten prescription drugs which are currently listed in the California Medical Assistance Program Formulary.

The Medi-Cal "Formulary" is a list of drugs maintained by The Department of Health Care Services for the State of California [hereinafter "the Department"] respondent herein. When a pharmaceutical product listed on the Formulary is prescribed by physicians to Medi-Cal beneficiaries, the "provider" of the drug (i.e., retail pharmacy, hospital pharmacy, physician, dentist or the like) can be reimbursed by the Medi-Cal program without prior authorization from the Department. Cal. Welf. & Inst. Code § 14053 (Deering); 22 Cal. Adm. Code 51001, 51005, 51313.

The Medi-Cal program, Cal. Welf. & Inst. Code § 14000, *et seq.* (Deering) was enacted to comply with Title XIX of the Federal Social Security Act, 42 U.S.C. § 1396, *et seq.* The Federal Social Security Act was adopted in 1965, and authorizes the Secretary of Health, Education and Welfare to make payments to the states whose medical assistance programs meet with the requirements of 42 U.S.C. § 1396a. The California Medi-Cal program provides a program of basic and extended health care services for recipients of public assistance programs. It qualifies for and receives substantial federal funding pursuant to Title XIX. Prescription drugs are one of the required services that must be provided under the Medical-Cal program. Cal. Welf. & Inst. Code § 14056 (Deering).

On January 1, 1969, Section 14053.5 of the California Welfare and Institutions Code became effective. Section 14053.5 deals with the pricing and distribution policies of pharmaceutical companies whose products are listed on the

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1. Pursuant to Rule 21(1) of the Rules of the Supreme Court, the parties have stipulated and agreed to omit specified portions of the record as unnecessary for the determination of this Petition. See, Stipulation Re Record for Petition for Writ of Certiorari, filed concurrently herewith.

References to the Stipulated Record are hereinafter referred to as "S.R."

Medi-Cal Formulary, and provides, in pertinent part, as follows:

> "For the purposes of the Medi-Cal Act, the terms 'prescribed drug' and 'prescription drug' shall not include any drug which, because of differing prices charged by the manufacturer on a discriminatory basis or discriminatory refusal to sell by the manufacturer, or both, is not available on the same terms and conditions to all providers of prescription services, or any drug which is found to be overpriced in comparison to another drug which has an equivalent therapeutic effect, unless the director determines that the drug is vital to the program and no acceptable substitute is available . . .
>
> "Nothing in this section shall be construed to apply to quantity or other nondiscriminatory discounts available on the same terms and conditions to all providers of prescription services, to sales by competitive bidding to federal, state or local governmental agencies, or to sales to wholesalers so long as the manufacturer does not require or induce the wholesalers to make the drug available other than on the same terms and conditions to all providers of prescription services . . ."

Thus, Section 14053.5 provides that a prescription drug covered by the Medi-Cal program may be removed from the program if: (1) the manufacturer charges *differing* prices on a "*discriminatory* basis;" or (2) the manufacturer engaged in a "*discriminatory* refusal to sell;" and (3) by reason of the foregoing, the drug product is not made available on the same terms and conditions to all providers of prescription services. Sales to wholesalers are exempt from the statute when the manufacturer does not exercise any control whatsoever over the terms and conditions of resale by the wholesaler to the ultimate providers of prescription services.

Soon after the effective date of Section 14053.5, the Department sought to remove Robins' products from the Medi-Cal Formulary because of Robins' drug pricing and distribution policies. Robins thereafter filed actions for declaratory and injunctive relief and mandate against the Department, seeking the declaration that Robins' pricing and distribution policies do not violate Section 14053.5 since they are not "discriminatory" within the meaning of Section 14053.5; or, in the alternative, that the interpretation of that Section, as applied by the Department is unconstitutional, as conflicting, *inter alia,* with Title 15, Section 13 of the United States Code. [S.R. 1-13; 49-59]. The trial court granted judgment in favor of Robins after concluding that the term "discriminatory," as used in Section 14053.5 means "unreasonable, arbitrary, and unfair," and that, based on the testimony before it, Robins' pricing and distribution policies were not discriminatory. Accordingly, the trial court deemed it unnecessary to rule upon the constitutional issues presented by Robins. [S.R. 27-39].

The judgment of the Sacramento County Superior Court was subsequently reversed by the California Court of Appeal. [Appendix I, 59 Cal.App.3d at 913.] In its decision, the Court of Appeal rejected the definition of "discriminatory" adopted by the trial court and held that Robins' pricing and distribution policies were "discriminatory" because Robins does not make available to *all* Medi-Cal prescription providers the *same* drugs at the *same* price. [Appendix I, 59 Cal.App.3d at 912].

Robins distribution policies, insofar as they are relevant here, can be summarized as follows: Robins sells its products directly to 53 non-profit hospitals and to 256 independent wholesale distributors in California. Robins does *not* make any direct sales whatsoever to the some 49,300

retail pharmacies, physicians, dentists and proprietary (i.e., profit-making) hospitals in the State of California. Instead, retail pharmacies, physicians and proprietary hospitals[2] obtain Robins' products from drug wholesalers. The price at which Robins sells to wholesalers is 16-2/3% off "list." The price at which Robins sells to non-profit hospitals is 20% off "list." The "list" price is the price the pharmaceutical industry quotes as the suggested sales price. [S.R. 30-31; Appendix I, 59 Cal.App.3d at 903].

Although there was some confusion as to the exact nature of the violation charged by the Department against Robins, the trial court ultimately found, as a conclusion of fact, that the Department contends that Robins violates Section 14053.5 *solely* because Robins sells its products directly to non-profit hospitals but does not sell its products directly to retail pharmacists and other proprietary providers of prescription services. [S.R. 35].

The uncontroverted testimony, as evidenced by the Department's Answers to Interrogatories [S.R. 89 at No. 17, S.R. 100 at No. 17] and incorporated into the trial court's Findings of Fact [S.R. 35-36] is that Robins' policy of selling directly to non-profit hospitals, but electing not to sell directly to retail pharmacies and other proprietary providers, is cost-justified, and is not unreasonable, unfair or arbitrary. The trial court found that the reason that Robins does not sell directly to retail pharmacies and proprietary providers is because it would be impossible for Robins, with its present limited facilities, to service such a large group of accounts in the State of California (approximately 49,300 retail pharmacies, physicians, and dentists).

2. For convenience, the retail pharmacies, physicians, dentists, and proprietary hospitals that comprise the proprietary providers of Robins' products (as compared to non-profit hospitals) will sometimes be referred to categorically herein as "proprietary providers."

[S.R. 35] Providing such direct distribution to retail drugstores would require that Robins perform the wholesalers' function in the distribution process, with its attendant obligations and problems—among them the problems of retailer credit and bad debts. The trial court concluded that it *would be more expensive for Robins to undertake such direct distribution to proprietary providers than to utilize wholesalers, with the end result that retail pharmacies and other proprietary providers would be forced to pay more for Robins' products than they do at the present time.* [S.R. 35-36]. Because the trial court concluded that the term "discriminatory" means "unreasonable, unfair, and arbitrary," and because it had been established that Robins' pricing and distribution policies were reasonably related to the costs of production, judgment was granted in favor of Robins. [S.R. 41-42].

By reversing the trial court's judgment, the decision of the California Court of Appeal, however, prohibits Robins from selling to non-profit hospitals at a lower rate (20% off list price) as long as retail pharmacists and other proprietary providers can only procure Robins' products at a greater rate through wholesalers (16-2/3% off list price)—*regardless* of Robins' valid, cost-justified basis for its refusal to sell directly to proprietary providers. By holding that ". . . the denial of the opportunity to proprietary providers of purchasing Robins' formulary drugs at the same price available to non-profit providers is in fact *discriminatory,* warranting their removal from approved Medi-Cal formulary drug status until such cost differential is eliminated," [Appendix I 59 Cal.App.3d at 911) the Court of Appeal thereby concluded that *any* difference in price constitutes the charging of prices on a "discriminatory" basis and *any* refusal to sell is a "discriminatory" refusal to sell within the purview of Section 14053.5.

Robins respectfully submits that such restrictions on a drug manufacturer's pricing and distribution policies constitute an unjustified and unconstitutional interference with interstate commerce, and, accordingly that, as interpreted by the California Court of Appeal, Section 14053.5 is unconstitutional in that it is preempted by and wholly conflicts with the Federal Robinson-Patman Act, 15 U.S.C. §§ 13(a)-(f). In addition, and because of the interpretation by the Court of Appeal, the operative effect of Section 14053.5 will be to *increase* drug prices to the State of California, thereby frustrating the policy of the Federal Medi-Care program, and conflicting with Title XIX of the Federal Social Security Act, 42 U.S.C. § 1396, *et seq.*

REASONS FOR GRANTING THE WRIT

1. As Interpreted by the California Court of Appeal, Section 14053.5 of the Welfare and Institutions Code Is Unconstitutional in That It Wholly Conflicts With the Federal Robinson-Patman Act.

The holding of the Court of Appeal requires Robins to sell its products at the same price to all providers—both nonprofit hospitals and proprietary providers alike—even though the uncontroverted testimony establishes that Robins' price differentials are cost justified. The Court of Appeal concluded that ". . . the denial of the opportunity to proprietary providers at *the same price* available to nonprofit providers is in fact discriminatory, warranting their removal from approved Medi-Cal formulary drugs status until such cost differential is eliminated." [Appendix I 59 Cal.App.3d at 911] (emphasis added).

The effect of the decision of the Court of Appeal is that Robins may no longer adjust the price of its products between various classes of purchasers to respond to varying market conditions. Instead, to remain on the Medi-Cal Formulary, Robins is required to sell at the *same* price to *all* classes of providers—regardless of the differences in costs and competition connected with its sale of particular products. Accordingly, by requiring a uniform price and prohibiting discounts to certain types of purchasers, Section 14053.5, as construed by the California Court of Appeal, creates price rigidity and frustrates the historical congressional purposes expressed by the federal anti-trust laws.

Following the determination of the California Court of Appeal that the term "discriminatory" in Section 14053.5 compels a drug manufacturer to offer its products at the *same* price to *all* providers, Section 14053.5 irreconcilably conflicts with the federal anti-trust laws in at least four respects:

(1) It prevents a drug manufacturer from passing onto purchasers the benefits of lower costs, a right preserved by Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a);

(2) It denies a drug manufacturer the right to meet lower competitive prices in good faith to individual purchasers, a right preserved by Section 2(b) of the Robinson-Patman Act, 15 U.S.C. § 13(b);

(3) By placing the burden on the drug manufacturer to insure that all proprietary providers receive the products at the same price, it compels a drug manufacturer to impose resale restrictions on its wholesalers, thereby amounting to vertical price-fixing and contrary to Section 1 of the Sherman Act, 15 U.S.C. § 1, and

(4) It requires such irrational price rigidity as to effectively stultify competition among drug manufacturers, thus seriously controverting the very purpose of federal anti-trust legislation.

(1) COST JUSTIFICATION

Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a), broadly prohibits certain acts of price discrimination by a seller to competing purchasers of its products. But Section 2(a) expressly preserves the right to sell at differing prices if such differentials "make only due allowance for differences in the cost of manufacture, sale or delivery resulting from the differing methods or quantities in which such commodities are sold or delivered."

By requiring that Robins' products be sold at the same price to all categories of providers, Section 14053.5 deprives Robins of the right to pass on to its customers the difference in costs it actually incurs in distributing its products between non-profit hospitals and proprietary providers. That right is expressly recognized by the proviso to Section 2(a) cited above.

The uncontradicted evidence at trial established Robins' *actual costs* of distribution for both non-profit and proprietary providers, and established more than a merely "reasonable approximation" of its distribution expenses. *Beatrice Foods Co.* 76 F.T.C. 719 (1969), *aff'd sub nom. Kroger Co. v. Federal Trade Commission,* 438 F.2d 1372 (6th Cir. 1971). The trial court expressly found that Robins' pricing and distribution policies were cost-justified. [S.R. 393].

The facts of this case are strikingly similar to those which were before the Sixth Circuit in *American Motors Corp. v. Federal Trade Commission*, 384 F2d. 247 (6th Cir. 1967), *cert. denied*, 390 U.S. 1012 (1968). In *American Motors,* as here, the manufacturer effected a price differential between two classes of purchasers—"merchandise distributors" (which, like Robins' wholesalers, operate out of key geographic areas) and "regular dealers" (i.e., numerous retail department and appliance stores, similar to the retail

pharmacies and other proprietary providers of Robins' drugs). The manufacturer in *American Motors* offered its product to "merchandise distributors" at discounts of slightly more than 3% off the price charged to "regular dealers." Under these circumstances, the Sixth Circuit held that the manufacturer's pricing system did not constitute illegal price discrimination, because the pricing system made due allowance for differences in the costs of sale resulting from different methods of sale to distributors and retailers. 384 F.2d at 251.

Section 14053.5, however, deprives Robins of its right to charge differing prices which can be cost-justified. Section 14053.5 deprives Robins of the right to adjust its prices in accordance with actual costs incurred by it in the distribution process, as expressly permitted to a seller under Section 2(a) of the Robinson-Patman Act.

(2) MEETING COMPETITION IN GOOD FAITH

Under Section 2(b) of the Robinson-Patman Act, 15 U.S.C. § 13(b), a seller who can show that it reduced its price to an *individual customer* "in good faith to meet an equally low price" offered to that same individual customer by a competitor of the seller does not commit unlawful price discrimination. *Standard Oil Co. v. Federal Trade Commission,* 340 U.S. 231, 249-250 (1951). Section 14053.5 however, prohibits the right to meet competition by requiring that the seller must offer the same lower price to *all* purchasers — regardless of the state of competition in the marketplace.

In other words, by requiring the *same* price to be offered to *all* providers, hospitals and pharmacies alike, the California statute leaves Robins with a Hobson's choice:

(1) If Robins chooses to grant the lower price it must do so across-the-board to all of its purchasers—even at the

risk of selling below its actual costs of production and distribution.

(2) If Robins chooses not to meet a competitor's lower price, the likely result is that it will lose that customer to its competitor.

In short, the effect of Section 14053.5 is to force the drug manufacturer to choose between "ruinously cutting its price to all its customers to match the price offered to one, or refusing to meet the competition and then ruinously raising its prices to its remaining customers to cover increased unit costs." *Standard Oil Co. v. Federal Trade Commission,* 340 U.S. at 250. In *Standard Oil,* the Supreme Court made it clear that the Robinson-Patman Act does not compel a seller to elect either of these disastrous alternatives:

> "[*I*]*f a large customer requests his seller to meet a temptingly lower price offered to him by one of his seller's competitors, the seller may well find it essential, as a matter of business survival, to meet that price rather than to lose the customer.* It might be that this customer is the seller's only available market for the major portion of the seller's product, and that the loss of this customer would result in forcing a much higher unit cost and higher sales price upon the seller's other customers. *There is nothing to show a congressional purpose, in such a situation, to compel the seller to choose only between ruinously cutting its price to all its customers to match the price offered to one, or refusing to meet the competition and then ruinously raising its price to its remaining customers to cover increased unit costs. There is, on the other hand, plain language and established practice which permits a seller, through § 2(b), to retain a customer by realistically meeting in good faith the price offered to that customer, without necessarily changing the seller's price to its other customers.*"
> 340 U.S. at 249-250 (emphasis added).

The "meeting competition" proviso of Section 2(b) of the Robinson-Patman Act embodies an absolute, but carefully prescribed, right of a seller to engage in individual price reductions essential in a competitive market place. Congress intended to recognize the right of each individual seller to determine whether to meet a competitive challenge. As the Federal Trade Comission advised Congress in 1941:

> "The amended (Robinson-Patman) Act now safeguards the *right* of a seller to discriminate in price in good faith to meet an equally low price of a competitor. *This right is guaranteed by statute and could not be curtailed by any mandate or order of the Commission.*" The Basing Point Problem, 139 Temporary National Economic Committee, Monograph No. 42, 1941 (emphasis added).

Section 14053.5, however, interdicts and negates that right, and is therefore in direct conflict with the federal law.

The right of a seller to compete fairly, and, when faced with a competitive challenge, the right of a seller to meet that competition to preserve its market, cannot be curtailed. *See, e.g., Report of the Attorney General's National Committee to Study the Anti-Trust Laws,* 181 (1955):

> "For a seller constrained by law to reduce prices to *some* only at the cost of reducing prices to *all* may well end by reducing them to *none.* As the Federal Trade Commission recently recommended to Congress, 'the right to meet a lower price which a competitor is offering to a customer, when this is done in good faith, *is the essence of competitive economy.*' *Anything less, we think, would move the price discrimination statute into irreconcilable conflict with the Sherman Act.*" (emphasis added).

This right enjoys long-standing judicial recognition. For example, the Supreme Court in *Fairmont Creamery Co. v. Minnesota,* 274 U.S. 1 (1927), declared unconstitutional a

Minnesota statute which contained a flat prohibition against price discrimination. Among its infirmities, the statute prevented a seller from meeting localized competition and required every buyer to adhere to a uniform price fixed by a single transaction. The Court held:

> "As the inhibition of the statute applies irrespective of motive, we have an obvious attempt to destroy plaintiff in error's liberty to enter into normal contracts, long regarded, not only as essential to the freedom of trade and commerce, but also as beneficial to the public. *Buyers in competitive markets must accommodate their bids to prices offered by others, and the payment of different prices at different places is the ordinary consequence. Enforcement of the statute would amount to fixing the price at which plaintiff in error may buy, since one purchase would establish this for all points, without regard to ordinary trade conditions.*" 274 U.S. at 8-9 (emphasis added).

In the recent case of *Shell Oil Co. v. Younger,* 1976-1 Trade Cases (CCH) ¶ 60,960, 69,246 (N.D. Cal., June 11, 1976) the United States District Court for the Northern District of California ruled that a California statute strikingly similar to Section 14053.5 was in irreconcilable conflict with the Robinson-Patman Act and was, therefore, unconstitutional and of no force and effect under the Supremacy Clause of the United States Constitution. The statute invalidated in the *Shell Oil* case banned price discrimination in the sale of fuel or oils, and provided in part, as follows:

> "It is unlawful for any refiner, distributor, manufacturer, or transporter of motor vehicle fuels or oils engaged in business in this state, either directly or indirectly, to discriminate in price between different purchasers of motor vehicle fuels or oils of like grade and quality, where the effect of such discrimination is to lessen competition, or to injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . ." Cal. Bus. & Prof. Code § 21200 (Deering).

The *Shell Oil* court found that the foregoing statute frustrated the congressional purpose embodied in Section 2(b) of the Robinson-Patman Act, to foster and encourage price competition; and that the California statute was in "direct, actual irreconcilable conflict with the Federal Clayton Act." 1976-1 Trade Cases (CCH) ¶ 60,960, 69,246.

For the reasons set forth above, Robins respectfully submits that because Section 14053.5 of the California Welfare and Institutions Code deprives Robins of its federally recognized right to compete fairly in the marketplace and is in direct and irreconcilable conflict with the Robinson-Patman Act. The California statute is therefore unconstitutional and void.

(3) VERTICAL PRICE FIXING

There are additional, independent reasons for striking down the California statute. The holding of the Court of Appeal would require Robins to sell its products to retail pharmacies at the same price as it sells to non-profit hospitals: ". . . [W]e hold that if a drug manufacturer elects to make available its drug products to proprietary providers only at prices higher than available to non-profit providers, the state may remove such drug products from its approved drug formulary list." [Appendix I; 59 Cal. App.3d at 912.]

There are two reasons why Robins cannot comply with this decision and offer its drug products to *all* retail pharmacies and non-profit hospitals at the *same* price:

first, it is economically impossible for Robins, with its limited facilities, to bypass its wholesalers and sell directly to the 49,100 retail pharmacies, physicians and dentists in the State of California; and secondly, under the federal anti-trust laws, Robins would be guilty of "vertical price fixing" if it exercised any control whatsoever over the terms, conditions and prices its wholesalers offer to retail pharmacies.

The uncontroverted testimony shows that Robins' election not to sell directly to retail pharmacies is cost-justified. Robins simply does not have the resources or capacity to service each of the 49,100 retail pharmacies, physicians and dentists in the State of California. To service these accounts, Robins would have to assume all of the functions now performed by its wholesalers—including record-keeping, narcotics control, around-the-clock servicing, and financing arrangements with each proprietary provider. Simply put, the statute would force Robins to enter into a business it never intended or planned to do. For Robins to undertake direct servicing to retail providers would invariably increase the costs of its drugs exponentially. Such an undertaking would clearly be economically infeasible.

On the other hand, if Robins wished to continue marketing through its wholesale distributors, it could not impose restrictions on its wholesalers to insure that proprietary providers could obtain Robins' formulary drugs at the same price available to non-profit hospitals. That would thrust Robins into a direct violation of federal law. An arrangement between a manufacturer and its wholesaler whereby the manufacturer controls the price of resale by retailers amounts to a vertical price-fixing agreement, which is a *per se* violation of Section 1 of the Sherman Anti-Trust Act, 15 U.S.C. § 1. See, *e.g., United States v. Parke, Davis and Company*, 362 U.S. 29 (1960); *Albrecht v. Herald Co.*,

390 U.S. 145 (1968); *Knutson v. Daily Review, Inc.*, 383 F. Supp. 1346 (N.D. Calif. 1974). As stated by the Supreme Court in *Albrecht:* "[T]he long-accepted rule in § 1 cases [is] that resale price fixing is a *per se* violation of the law whether done by agreement or combination." 390 U.S. at 151. And in *United States v. Parke, Davis and Company, supra,* where a drug manufacturer refused to permit its wholesalers to fill orders from those retailers which had failed to follow the manufacturer's "suggested retail prices," the Supreme Court held that the drug manufacturer was the organizer of a price maintenance combination in violation of the Sherman Act, stating: "[A] combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in inter-state or foreign commerce is illegal *per se.*"[3] 362 U.S. at 47, quoting *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940).

In short, to compel a drug manufacturer to make its drugs available to proprietary providers at the same price available to non-profit providers in order to maintain those drugs on the Medi-Cal Formulary is to require a result that could be accomplished only by manufacturer intervention in the terms and conditions of resale by its wholesalers. Such a result is prohibited by the Federal Sherman Anti-Trust Act.

(4) FRUSTRATION OF CONGRESSIONAL POLICY

The basic purpose of the federal anti-trust laws is to foster and to maintain price competition. Sections 2(a) and 2(b) of the Robinson-Patman Act expressly permit price differentials where a seller can establish cost justification

3. Here, the trial court found, as a finding of fact, that Robins does *not exercise* control over the prices, terms, and conditions of the resale of its pharmaceutical products by wholesalers. [S.R. 32]

therefor, or can establish that prices were adjusted in response to meet the good faith competition of a competitor. Indeed, the Supreme Court has described Congress' purpose in enacting Section 2(b) as follows:

> "*The heart of our national economic policy has long been faith in the value of competition.* In the Sherman and Clayton Acts, as well as in the Robinson-Patman Act, 'Congress was dealing with competition, which it sought to protect, and monopoly, which it sought to prevent.' We need not now reconcile, in its entirety, the economic theory which underlies the Robinson-Patman Act with that of the Sherman and Clayton Acts. *It is enough to say that Congress did not seek by the Robinson-Patman Act either to abolish competition or so radically to curtail it that a seller would have no substantial right or self-defense against a price raid by a competitor . . .*" *Standard Oil Co. v. Federal Trade Commission,* 340 U.S. 231, 248-249 (citations omitted) (emphasis added).

Likewise, in evaluating the effects of price differentitals, the Supreme Court has emphasized the need for careful analysis of the relevant competitive facts:

> ". . . 'In appraising the effects of any price cut or the corresponding response to it, both the Federal Trade Commission and the courts must make realistic appraisals of the relevant competitive facts. Invocation of mechanical word formulas cannot be made to substitute for adequate probative analysis." *Federal Trade Commission v. Sun Oil Company,* 371 U.S. 505, 527 (1963).

Here, however, the California statute, as interpreted by the California Court of Appeal, substitutes its own "mechanical word formula" in place of "realistic appraisal of the relevant competitive facts." By requiring Robins to sell its products at the *same* price to *all* classes of providers,

the operative effect of Section 14053.5 is to prohibit Robins from adjusting its prices between various classes of purchasers to respond to varying market conditions. Accordingly, Section 14053.5 creates such inflexibility and price rigidity that it is in irreconcilable conflict with the Sherman and Clayton Act.

2. Welfare and Institutions Code Section 14053.5 as Implemented by the State of California Is Irreconsilable and Incompatible with Title XIX of the Social Security Act (42 U.S.C. § 1396, et seq.) and Therefore Invalid as a Violation of the Supremacy Clause of the United States Constitution.

Title XIX of the Social Security Act, 42 U.S.C. § 1396 *et seq.,* enacted by Congress in 1965, authorizes the Secretary of Health, Education and Welfare to make payments to states whose medical assistance programs meet with the requirements of 42 U.S.C. § 1396a. The purpose of Title XIX is to provide federal assistance to states whose approved plans of medical assistance conform to the federal standards which require an efficient, economic and quality program of medical assistance for indigents. 42 U.S.C. § 1396a. Among the required services to be provided are prescription drugs. 42 U.S.C. § 1396a(30). A state plan to be consistent with Title XIX must provide medical care and services, including drugs, with simplicity of administration and in the best interests of the recipients. 42 U.S.C. § 1396a(19). Moreover, Title XIX expressly provides that the state plan must also assure that payments, including payments for drugs, are not in excess of reasonable charges consistent with efficient, economic and quality care. 42 U.S.C. § 1396a(30).

Sections 14000, *et seq.* of the California Welfare and Institutions Code was adopted by the California Legislature in 1965 to comply with the requirements of Title XIX. The California plan has been approved by the Secretary of

Health, Education and Welfare, and California receives substantial federal funding annually for its Medi-Cal program. Prescription drugs are one of the mandatory services that must be provided for under Medi-Cal. Cal. Welf. & Inst. Code §§ 14053, 14056 (Deering).

Section 14053.5 of the California Welfare and Institutions Code was adopted by the California legislature in 1968 to deal with the pricing and distribution policies of pharmaceutical manufacturers whose products are listed on the Medi-Cal Formulary. As interpreted by the Court of Appeal, Section 14053.5 renders a drug manufacturer's products ineligible for the Medi-Cal program where the drug manufacturer offers its products to nonprofit hospitals at a 20% discount from list price, but where proprietary providers can purchase the products only from wholesalers at 10% below list price. [Appendix I, 59 Cal.App.3d at 908-909.] Accordingly, because Robins has elected to make its drugs available at a lower price to non-profit hospitals than to proprietary providers, the Court of Appeals concluded that this pricing structure is "discriminatory" within Section 14053.5 [Appendix I, 59 Cal.App.3d at 908-909].

If, however, Robins had elected to eliminate the 20% discount now available to non-profit hospitals, and make its products available to non-profit hospitals and other proprietary providers at the same price, this would have been permissible under the Court of Appeal's interpretation of Section 14053.5. In other words, Robins could comply with the statute if it simply increased the costs of its drugs to non-profit hospitals. Robins submits that this result is clearly contrary to the stated purpose of Title XIX in that it does *not* promote efficient, economic quality of care but rather directly results in higher costs to both the State of California and the Federal Government for reimbursement under Title XIX.

In short, the State of California through the implementation of Section 14053.5 of the Welfare and Institutions Code is utilizing Title XIX of the Social Security Act as the vehicle for altering methods of prescription drug distribution and pricing within California. The effect of the state statute is to eliminate favorable discounts to non-profit hospitals, thereby requiring non-profit hospitals to purchase prescription drugs through wholesalers at a higher price, which in turn is translated into additional costs to the State of California and the federal government without any concomitant savings to the State of California or the federal government.

In fact, the response of the pharmaceutical industry to Section 14053.5 as interpreted by the California Department of Health, has been to discontinue *all* hospital discounts, thereby forcing hospitals to acquire their pharmaceuticals through wholesalers at a higher price. This, in turn, has resulted in higher costs of pharmaceuticals for *all* hospital patients—not just Medi-Cal patients—together with increased costs of reimbursement for the State of California and the federal government under the Medi-Cal program and Title XIX of the Social Security Act. See: "A Review of Wholesale and Retail Pricing and Marketing Practice for Prescription Drugs in California," Assembly Concurrent Resolution No. 184, 1970 Session, Legislative Analyst, State of California (January 8, 1971).

Because the operative effect of Section 14053.5 is to increase costs, it conflicts with and frustrates the purposes of the Title XIX requirement that payments for drugs are not in excess of reasonable charges and are consistent with efficient, economic and quality care, Section 14053.5 is in irreconcilable conflict with and is preempted by Title XIX, under the Supremacy Clause of the United States Consti-

tution. In *Perez v. Campbell,* 402 U.S. 637 (1971), the Supreme Court held that any state legislation which frustrates the full effectiveness of a federal law is rendered invalid by the Supremacy Clause, even if the state statute purports to regulate some valid state purpose:

> "We can no longer adhere to the aberrational doctrine . . . that state law may frustrate the operation of federal law as long as the state legislature in passing its law had some purpose in mind other than one of frustration. Apart from the fact that it is at odds with the approach taken in nearly all our Supremacy Clause cases, such a doctrine would enable state legislatures to nullify nearly all unwanted federal legislation by simply publishing a legislative committee report articulating some state interest or policy—other than frustration of the federal objective—that would be tangentially furthered by the proposed state law . . . [T]he controlling principle [is] that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause." 402 U.S. at 651-652 (citations omitted).

Concededly, a statute adopted by the State of California for the purpose of reducing the costs to the state and federal governments of prescription drugs provided to Medi-Cal beneficiaries would be consistent with the purposes and aims of Title XIX. Here, however, California has adopted a statute and implemented it in a fashion that terminates favorable prices to non-profit hospitals with the result that the costs of prescription drugs to all Medi-Cal patients are increased. The state statute clearly "frustrates the full effectiveness" of Title XIX and is, therefore, invalid under the Supremacy Clause of the United States Constitution.

CONCLUSION

For the reasons set forth above, Robins respectfully requests the issuance of a writ of certiorari to review the judgment and opinion of the California Court of Appeal, Third Appellate District.

Dated: December 10, 1976.

Respectfuly submitted,

EDGAR B. WASHBURN
LANDELS, RIPLEY & DIAMOND
450 Pacific Avenue
San Francisco, California 94133
Telephone: (415) 788-5000
Attorney for Petitioner,
A. H. Robins, Inc.

(Appendix Follows)

Appendix I

[Civ. No. 13793. Third Dist. July 1, 1976.]

A. H. ROBINS COMPANY, INCORPORATED,

Plaintiff and Respondent, v.

DEPARTMENT OF HEALTH et al., Defendants and Appellants.

COUNSEL

Landels, Ripley & Diamond, Edgar B. Washburn and Fredrick M. Wooster for Plaintiff and Respondent.

Evelle J. Younger, Attorney General and John Fourt, Deputy Attorney General, for Defendants and Appellants.

SUMMARY

A drug manufacturer was found by the state director of health care services and then by an administrative law judge to have violated Welf. & Inst. Code, § 14053.5, which provides for stopping of the state's drug purchases under the Medi-Cal program when a drug manufacturer has engaged in discriminatory marketing practices. The manufacturer then sought judicial review of the administrative decision, and the trial court granted it a peremptory writ of mandate, requiring the director of health care services to set aside his decision. Finding that the term "discrimination" as used in Welf. & Inst. Code, § 14053.5, means unreasonable and unfair, the court held to be nondiscriminatory the manufacturer's multiple pricing system whereby nonprofit hospital and governmental agencies could buy direct from the manufacturer at a 20 percent discount from list

price, but private hospitals, pharmacies, and medical and dental practitioners could buy only from wholesalers at 10 percent below list price. (Superior Court of Sacramento County, No. 13793, B. Abbott Goldberg, Judge.)

The Court of Appeal reversed and directed the trial court to dismiss the petition for writ of mandate. The court held that the word "discriminatory" as used in Welf. & Inst. Code, § 14053.5, refers to price differentials with respect to different buyers and not to reasonableness or fairness, and that the manufacturer's marketing practices were therefore discriminatory. The court also held that Welf. & Inst. Code, § 14053.5, is a reasonable exercise by the state of its police power, taking note of its valid regulatory purpose to make available, at nondiscriminatory prices, a broad range and efficient source of drugs needed by Medi-Cal patients.

OPINION

CARTER, J.*—This is an appeal from a judgment granting plaintiff A. H. Robins Company, Incorporated, a corporation (hereinafter "Robins") a peremptory writ of mandamus commanding the Director of Health Care Services (then Earl W. Brian, M.D.) to set aside his decision dated June 15, 1970, which found Robins to be in violation of Welfare and Institutions Code section 14053.5. The judgment also dismissed, without prejudice, Robins' initial complaint for declaratory and injunctive relief.

In general, Welfare and Institutions Code section 14053.5 is designed to halt the state's purchase of drugs under the Medi-Cal program when a drug manufacturer has indulged in discriminatory marketing practices. The offending marketing practices are specifically described in this statute, the full text of which, as amended in 1971, we append in the margin.[1]

*Retired judge of the superior court sitting under assignment by the Chairman of the Judicial Council.

On August 26, 1969, Robins filed a complaint for declaratory and injunctive relief against defendants (action No. 195213), challenging the constitutionality of the application of section 14053.5 to Robins' business practices. As a result of that action, the parties stipulated to a hearing in accordance with the Administrative Procedure Act. The hearing officer specifically found that Robins' marketing practices resulted in price discrimination between, and discriminatory refusal to sell to, providers of prescription services, and declared that Robins' drug products were accordingly not eligible for the California Medical Assistance Program.

Thereafter Robins filed a new action (No. 203631) in order to obtain judicial review of the administrative deci-

[1]Section 14053.5: "For the purposes of the Medi-Cal Act, the terms 'prescribed drug' and 'prescription drug' shall not include any drug which, because of differing prices charged by the manufacturer on a discriminatory basis or discriminatory refusal to sell by the manufacturer, or both, is not available on the same terms 'prescribed drug' and 'prescription drug' shall not include any drug which is found to be overpriced in comparison to another drug which has an equivalent therapeutic effect, unless the director determines that the drug is vital to the program and no acceptable substitute is available.

"Before the director determines that any drug has an equivalent therapeutic effect in comparison to another drug, or is vital to the program and no acceptable substitute is available, he must have received a report to that effect from the Medical Therapeutics and Drug Advisory Committee.

"Nothing in this section shall be construed to apply to quantity or other nondiscriminatory discounts available on the same terms and conditions to all providers of prescription services, to sales by competitive bidding to federal, state or local governmental agencies, or to sales to wholesalers so long as the manufacturer does not require or induce the wholesalers to make the drug available other than on the same terms and conditions to all providers of prescription services.

"This section shall not be construed to deny reimbursement to hospitals for prescribed drugs furnished to inpatients or, unless the regulations provide to the contrary, to registered outpatients."

sion. The two cases were consolidated by the trial court and the state was enjoined from removing Robins' products from the Medi-Cal Drug Formulary pending final judicial determination.

Thereafter, upon application of the state, we issued a writ of prohibition restraining the trial court from enforcing an order granting post-adminstrative discovery to Robins and placed the litigation in a posture for trial court review of the administrative decision. (See *State of California v. Superior Court* (1971) 16 Cal.App.3d 87 [93 Cal.Rptr. 663].)

Following extensive briefing by the parties, the trial court found that the term "discriminatory" as used in section 14053.5 means unreasonable, unfair and arbitrary, and that Robins' marketing practices did not violate the terms of section 14053.5.

(1) Where the "independent judgment on the evidence" rule fixes the scope of the superior court's administrative review, the appellate court's factual inquiry is limited to ascertaining whether the findings of the superior court are supported by substantial evidence. When, in contrast, the evidence is undisputed, the superior court's review represents an inquiry of law (not one of fact) and the appellate court's inquiry is not circumscribed by the substantial evidence rule. (*David Kikkert & Associates, Inc. v. Shine* (1970) 6 Cal.App.3d 112, 116 [86 Cal.Rptr. 161].) Here there is no dispute concerning Robins' marketing and pricing practices.

The undisputed facts establish that Robins is a pharmaceutical company whose main business is the development, promotion and sale of pharmaceutical products, ten of which are listed in the California Medical Assistance Program formulary. The physical distribution of Robins' drug products is made from warehouses located in Richmond, Virginia; Los Angeles, California; Chicago, Illinois; and Dallas, Texas. Robins publishes a "list price" for its drug products, including the ten drugs listed in the administrative accusation which the state seeks to have removed from the California Medical Assistance Program.

Such list prescribes the price which the drug wholesaler uses to sell Robins' products, subject to a 2 percent cash discount. Robins discontinued direct sales to community retail pharmacists, physicians and dentists in private practice in December of 1952. In addition, Robins discontinued direct sales to proprietary hospitals in January of 1969. Prior to this latter date, proprietary hospitals, by making direct purchases, were allowed a discount of 20 percent from the list price in addition to a 2 percent discount for payment within 30 days. Thus since 1952, community retail pharmacists, physicians and dentists in private practice have been able to obtain Robins' drug products only from drug wholesalers. Such wholesalers have also been the only source of Robins' products for proprietary hospitals since December of 1968. Robins sells its drug products directly to drug wholesalers at list price less a 16⅔ percent discount, and allows an additional 2 percent discount for cash. In the case of narcotics, the wholesaler is given a discount of 20 percent off list price.

The multiple pricing structure of Robins' products provides that nonprofit general hospitals and affiliated nursing homes, federal, state and local governments may buy the ten challenged specified pharmaceutical products at a 20 percent discount below list price by direct purchase from Robins. It is undisputed that community retail pharmacists, proprietary general hospitals, proprietary nursing homes, and individual providers of prescription services such as physicians and dentists may only purchase the ten pharma-

ceutical products through a wholesaler at list price or in volume at 10 percent below list. In 1969 the State of California spent over $67,000,000 for drug products under the Medi-Cal program, with over 90 percent of such drugs being purchased from community retail pharmacist providers.

(2a) An examination of the legislative history of section 14053.5 establishes that the State of California intended to utilize its purchasing power under the Medi-Cal program to prevent marketing price discrimination between various authorized providers, in order to prevent the state from paying a higher price for the same drugs provided Medi-Cal patients simply because the nature or status of the provider might be different.

In the February 1967 Report of the Assembly Subcommittee on Health Education and Welfare Services on Drug Prices (Assembly Interim Committee on Ways and Means, volume 21, No. 18, to be found in the Appendix to the Journal of the California Assembly, 1967, vol. 2), referring specifically to "Multiple Pricing Practices," the report squarely addressed itself to the multiple pricing practices of drug manufacturers. The subcommittee report noted that certain drug manufacturers charged hospitals and clinics a lower price (regardless of the quantity purchased) than the price charged community pharmacies for the same drugs, and thus to the extent that such community pharmacies were forced to pay higher prices for the drugs later supplied to Medi-Cal program recipients, state pharmaceutical expenditures were inflated. The problem was likewise considered by the Senate in July of 1967 (Senate Resolution No. 337, Senate Journal p. 3644) and ultimately resulted in the enactment of section 14053.5 of the Welfare and Institutions Code.

(3a) We hold the trial court erred in concluding Robins' multiple pricing system did not come within the provisions of section 14053.5, since the language of the statute provides that a "prescribed drug" or "prescription drug" under the Medi-Cal program shall *not* include any drugs for which: (1) the manufacturer charges different prices to different categories of providers of prescription services; (2) the drug price is fixed by the mauufacturer on a discriminatory basis; (3) the drug is unavailable to one or more classes of providers except on different terms and conditions than those available to other classes of providers; (4) the unavailability of the drug on the same terms and conditions to all classes of prescription providers is due to differing prices charged by the manufacturer on a discriminatory basis.

Applying these exclusionary criteria, there is simply no dispute that pharmacies operated by a proprietary hospital, community retail pharmacies and physicians and dentists in private practice are unable to obtain the ten challenged drug products at the same price discount from list charged nonprofit hospitals or pharmacies operated by nonprofit hospitals, this in spite of the fact that both proprietary as well as nonprofit providers are specifically recognized as Medi-Cal drug providers. It is uncontradicted that Robins' formulary drug products are available to proprietary providers only through a drug wholesaler at 10 percent below list price. Thus the challenged drugs are unavailable to one or more classes of providers (here the proprietary providers), except at a different price than available to other classes of providers (nonprofit providers). Finally, the reason why Robins' ten questioned drug products are unavailable on the same terms and conditions to all providers is due to the differing prices charged by Robins on a dis-

criminatory basis, namely, refusing to make the drug available to proprietary providers at the same price as such drugs are made available to nonprofit providers.

Appellant state agency urges the trial court erred in concluding Robins' *refusal to sell* to proprietary providers did not come within the provisions of section 14053.5. Robins' *refusal to sell to proprietary providers,* without more, is not an issue in this case. (Cf. *United States v. Colgate & Co.* (1919) 250 U.S. 300 [63 L.Ed. 992, 39 S.Ct. 465, 7 A.L.R. 443]; *A.B.C. Distrib. Co. v. Distillers Distr. Corp.* (1957) 154 Cal.App.2d 175, 189 [316 P.2d 71]; *Cal. Bev. etc. Co. v. Distillers Distrib. Corp.* (1958) 158 Cal. App.2d 758 [323 P.2d 517].) The record is uncontradicted that Robins' drug products are available to all Medi-Cal providers, either by direct sales to nonprofit providers or indirect sales through drug wholesalers to proprietary providers. Thus Robins' marketing practices without a price differential are not factually before us. It is not the variety of marketing techniques or arrangements which is contrary to section 14053.5 so long as such marketing practices permit the challenged drugs to reach the hands of all drug providers at the same cost price subject only to quantity and time of payment discounts. (2b) We think it apparent that section 14053.5 precisely intended to prevent a variation in the acquisition cost of drugs, which in turn would vary the billing costs of the same drugs, depending upon where a Medi-Cal patient elected to have a prescription provided. (See *Zimmerman v. Brian* (1974) 41 Cal. App.3d 563, 566-567 [116 Cal.Rptr. 211].)

(4) The trial court concluded that the word "discriminatory," as used in section 14053.5, means "unreasonable, unfair and arbitrary."

Webster's New International Dictionary (Second Edition, Merriam, Springfield, Mass. (1950)), page 745, states "discriminatory" means "discriminative; showing favoritism." Further, "discrimination" means: "4. A distinction, as in treatment; esp., an unfair or injurious distinction. Spec., arbitrary imposition of unequal tariffs for substantially the same service; a difference in treatment made between persons, localities, or classes of traffic, in respect of substantially the same service." (Webster's, *op. cit.,* at p. 745.)

The legislative history of section 14053.5 fairly demonstrates that price differentials, not reasonableness or fairness, formed the statutory objective. Both the Senate and Assembly by identical resolutions directed appellant to eliminate multiple pricing practices of drug manufacturers related to the Medi-Cal program, particularly noting that such discriminatory pricing practices forced retail pharmacies "to pay higher wholesale prices for the same quantity of a given drug purchased than other buyers pay; . . . ." (Senate Resolution No. 337, Senate Journal, p. 3644, July 13, 1967; Assembly House Resolution No. 443, Assembly Journal, p. 5226, July 13, 1967.) Thus the kind of discrimination which the statute condemns involves the case at bench where proprietary providers must pay a higher acquisition price than charged to nonprofit providers for the same drugs. To the extent that Medi-Cal patients utilize proprietary providers, requiring the state to pay a higher cost for the same drug prescription, such price marketing discrimination tends to diminish efficient and economic utilization of Medi-Cal funds.

(3b) Accordingly, we conclude that the denial of the opportunity to proprietary providers of purchasing Robins' formulary drugs at the same price available to nonprofit providers is in fact discriminatory, warranting their removal from approved Medi-Cal formulary drug status until such cost differential is eliminated.

(5) Robins contends that the federal government by acting in the area of price discounts to nonprofit institutions has preempted the field and thus the State of California is not free to legislate in any fashion that would conflict with the federal statute. (The provision exempting nonprofit institutions (15 U.S.C. § 13c), relied upon by Robins, provides in pertinent part as follows: "Nothing in Section 13 to 13b and 21a of this title [the Robinson-Patman Price Discrimination Act], shall apply to purchases of their supplies for their own use by schools, colleges, universities, public libraries, churches, *hospitals* and charitable institutions not operated for profit." (Italics added.)

Robins urges that "to the extent that § 14053.5 is applied in a manner that prevents non-profit hospitals and the manufacturers who sell to such institutions from taking advantage of 15 U.S.C. § 13(c)" such application by appellants runs afoul the supremacy clause of the United States Constitution (art. VI).

Initially we note that the United States Supreme Court, on March 24, 1976, decided *Abbott Labs. v. Portland Retail Druggists,*—U.S.—[47 L.Ed.2d 537, 96 S.Ct.—] in which the court carefully delineated the type of drug dispensations which are to be categorized for a nonprofit hospital's "own use" and thus exempt from the Robinson-Patman Act by the provisions of section 13c. The court stated (p. 547): ". . . it seems to us to be very clear that a hospital's purchase of pharmaceutical products that are dispensed to and consumed by a patient on the hospital premises, whether that patient is bedded, or is seen in the emergency facility, or is only an outpatient, is a purchase of supplies for the hospital's 'own use,' within § 13c."

The court further stated (p. 549): "We therefore conclude that the exemption provision of the Nonprofit Institutions Act is a limited one; that just because it is a nonprofit hospital that is purchasing pharmaceutical products does not mean that all its purchases are exempt from Robinson-Patman; that the test is the obvious one inherent in the language of the statute, namely, 'purchases of their supplies for their own use'; and that 'their own use' is what reasonably may be regarded as use *by the hospital* in the sense that such use is a part of and promotes the hospital's intended institutional operation in the care of persons who are its patients. This implies the limitation and it turns the measure naturally from the purchase to the use, as § 13c requires. . . ."

Mindful of this recent decision by our highest court, we reject Robins' contention for several reasons.

Section 14053.5 does not prevent Robins from selling any of its drug products to nonprofit hospitals at an exempt 15 U.S.C. section 13c discriminatory price within the declared scope of *Abbott Laboratories, supra.* Nor do we perceive that the State of California could prevent Robins from doing so contrary to the now declared permissible exemption.

The question before us is not the right of Robins to sell its drug products at a discriminatory price free from a possible Robinson-Patman violation, but whether the State of California can remove from its approved drug formulary list certain Robins drug products because Robins has elected not to make available to all Medi-Cal prescription drug providers the same drugs at the same cost price.

The right of a manufacturer to sell its drug products does not guarantee either initial or continuing product eligibility of such drugs on the state's Medi-Cal formulary list. Accordingly, we hold that if a drug manufacturer elects to make available its drug products to proprietary

providers only at prices higher than available to nonprofit providers, the state may remove such drug products from its approved drug formulary list.

Such action does not interfere with Robins' right to do business with any person, business or institution in the state; it simply means that a dispenser of such drugs to Medi-Cal patients may not look to the state for payment, as such drugs are not on the state's formulary list of approved drugs.

(2c) Finally, Robins urges that section 14053.5 as applied by appellants constitutes an unreasonable exercise of the police power, not reasonably related to any valid regulatory purpose, and thus is a denial of due process.

This contention is without merit, since one purpose of section 14053.5 is to insure that Medi-Cal patients, and necessarily the state, are not compelled to pay a higher price for the same drug simply because the dispenser is a proprietary provider. This is a matter of significant state concern since, as shown by the record, approximately 90 percent of all Medi-Cal patient prescriptions are filled by proprietary providers. Under the Medi-Cal program, the choice of the provider rests with the patient. The ultimate cost of the prescription is paid by the state. As observed by the trial court in its intended decision: "The Medi-Cal patients to whom drugs are dispensed through [nonprofit] hospitals have a price advantage denied to the vast majority to whom drugs are dispensed through retail outlets." Conversely, the Medi-Cal patients to whom drugs are dispensed through proprietary hospitals, physicians and retail pharmacies are required to pay more for the same drugs because of Robins' price marketing practices. Thus the Robins formulary products cost Medi-Cal patients more or less for the identical drug based only upon where the prescription is ultimately filled.

The challenged statute is a proper exercise of the state's police power, since it demonstrates legislative concern with the preservation, cooperation and utilization of private enterprise drug providers in order to make available a broad, convenient and efficient source of drug products needed by Medi-Cal patients at nondiscriminatory prices.

The judgment in action number 203631 is reversed and the trial court is directed to dismiss the petition for writ of mandate.

The judgment of dismissal in action number 195213 is affirmed.

Appellants to recover costs.

Friedman, Acting P. J., and Janes, J., concurred.

Appendix II

(1) California Welfare and Institutions Code Section 14053.5.

§ 14053.5. Same: Discriminations, etc., resulting in exclusion from terms "prescribed drug" in absence of determination of unavailability of acceptable substitute: Exceptions

For the purposes of subdivision 12 of Section 14053, the term "prescribed drug" shall not include any drug which, because of differing prices charged by the manufacturer on a discriminatory basis or discriminatory refusal to sell by the manufacturer, or both, is not available on the same terms and conditions to all providers of prescription services, or any drug which is found to be overpriced in comparison to another drug which has an equivalent therapeutic effect, unless the director determines that the drug is vital to the program and no acceptable substitute is available.

Before the director determines that any drug has an equivalent therapeutic effect in comparison to another drug, or is vital to the program and no acceptable substitute is available, he must have received a report to that effect from the Medical Therapeutics and Drug Advisory Committee.

Nothing in this section shall be construed to apply to quantity or other nondiscriminatory discounts available on the same terms and conditions to all providers of prescription services, to sales by competitive bidding to federal, state or local governmental agencies, or to sales to wholesalers so long as the manufacturer does not require or induce the wholesalers to make the drug available other than on the same terms and conditions to all providers of prescription services.

This section shall not be construed to deny reimbursement to hospitals for prescribed drugs furnished to inpatients or, unless the regulations provide to the contrary, to registered outpatients.

(2) The Robinson-Patman Act, 15 U.S.C. § 13(a)-(f).

§ 13. Discrimination in price, services, or facilities—Price; selection of customers

(a) It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: *Provided,* That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: *Provided, however,* That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or classes of commodities, where it finds that available purchasers in greater quanti-

ties are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: *And provided further,* That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: *And provided further,* That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioratiion of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

Burden of rebutting prima-facie case of discrimination

(b) Upon proof being made, at any hearing on a complaint under this section, that there has been discrimination in price or services or facilities furnished, the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation of this section, and unless justification shall be affirmatively shown, the Commission is authorized to issue an order terminating the discrimination: *Provided, however,* That nothing herein contained shall prevent a seller rebutting the prima-facie case thus made by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

Payment or acceptance of commission, brokerage or other compensation

(c) It shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact for or in behalf, or is subject to the direct or indirect control, of any party to such transaction other than the person by whom such compensation is so granted or paid.

Payment for services or facilities for processing or sale

(d) It shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

Furnishing services or facilities for processing, handling, etc.

(e) It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or pur-

chasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale, or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms.

Knowingly inducing or receiving discriminatory price

(f) It shall be unlawful for any person engaged in commerce, in the course of such commerce, knowinglly to induce or receive a discrimination in price which is prohibited by this section.

Oct. 15, 1914, c. 323, § 2, 38 Stat. 730; June 19, 1936, c. 592, § 1, 49 Stat. 1526.

(3) Title XIX, Social Security Act, 42 U.S.C. § 1396a.

§ 1396a. State plans for medical assistance—Contents

(a) A State plan for medical assistance must—

(1) provide that it shall be in effect in all political subdivisions of the State, and, if administered by them, be mandatory upon them;

(2) provide for financial participation by the State equal to not less than 40 per centum of the non-Federal share of the expenditures under the plan with respect to which payments under section 1396b of this title are authorized by this subchapter; and, effective July 1, 1969, provide for financial participation by the State equal to all of such non-Federal share or provide for distribution of funds from Federal or State sources, for carrying out the State plan, on an equalization or other basis which will assure that the lack of adequate funds from local sources will not result in lowering the amount, duration, scope, or quality of care and services available under the plan; . . .

(19) provide such safeguards as may be necessary to assure that eligibility for care and services under the plan will be determined, and such care and services will be provided in a manner consistent with simplicity of administration and the best interests of the recipients; . . .

(30) provide such methods and procedures relating to the utilization of, and the payment for, care and services available under the plan (including but not limited to utilization review plans as provided for in section 1396b(i)(4) of this title) as may be necessary to safeguard against unnecessary utilization of such care and services and to assure that payments (including payments for any drugs provided under the plan) are not in excess of reasonable charges consistent with efficiency, economy, and quality of care; . . .

(4) United States Constitution, Article VI, Clause 2.

Clause 2. Supreme Law of Land

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

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